Supreme Court, U. S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-304

CONTINENTAL CASUALTY COMPANY,
Petitioner,

v.

THE WINSTON CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1975

No.

CONTINENTAL CASUALTY COMPANY,

Petitioner,

v.

THE WINSTON CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Petitioner, Continental Casualty Company, a corporation, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Sixth Circuit entered on January 17, 1975, rehearing denied April 2, 1975.

OPINIONS BELOW

The opinion of the United States Court of Appeals for the Sixth Circuit (App. A, *infra*, p. 1a) is reported

in 508 F.2d 1298. The opinion of the District Court (App. B, *infra*, p. 1b) is reported in 361 F. Supp. 1023 (1973).

JURISDICTION

The opinion and judgment of the United States Court of Appeals for the Sixth Circuit were entered on January 17, 1975 (App. A. *infra*, p. 1a, 508 F.2d 1298). Continental's petition for rehearing was denied by order of April 2, 1975 (App. C, *infra*, p. 1c). On June 14, 1975, Mr. Justice Stewart extended the time within which to file petition for a writ of certiorari to and including August 30, 1975. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the United States Court of Appeals for the Sixth Circuit failed to apply or improperly applied the Rules of Decision Act when, in a pure diversity case with no existing competing federal interest, the Court of Appeals by-passed and declined to follow pertinent and controlling Georgia statutory and appellate decisional suretyship law;* instead substituted its belief as to what the Supreme Court of Georgia would do in this and future litigation; and by such approach and process reversed the judgment of the District Court for Continental and directed judgment against it and for Winston?

**Gooding v. Wilson*, 405 U.S. 518, 526 footnote 3, (1972), *infra*, p. 11.

STATUTE OF THE UNITED STATES INVOLVED

28 U.S.C. 1652:

"§ 1652. *State laws as rules of decision*

"The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply."

STATUTES OF GEORGIA INVOLVED
(Annotated Code of Georgia)

Section 103-101:

"103-101. (3538) *Definition; guaranty distinguished.*—The contract of suretyship is one whereby a person obligates himself to pay the debt of another in consideration of credit or indulgence, or other benefit given to his principal, the principal remaining bound therefor. It differs from a guaranty in this, that the consideration of the latter is a benefit flowing to the guarantor."

Section 103-103:

"103-103. (3540) *Suretyship not extended by implication.*—The contract of suretyship is one of strict law, and the surety's liability will not be extended by implication or interpretation."

Section 103-202:

"103-202. (3543) *Novation; discharge of surety.*—Any change in the nature or terms of a contract is called a novation; such novation, without the consent of the surety, discharges him."

Section 103-203:

"103-203. (3544) *Discharge of surety by increase of risk.*—Any act of the creditor, either before or after judgment against the principal, which injures the surety or increases his risk, or exposes him to greater liability, shall discharge him; a mere failure by the creditor to sue as soon as the law allows, or neglect to prosecute with vigor his legal remedies, unless for a consideration, shall not release the surety."

Section 53-503:

"53-503 (3007) *Wife feme sole as to her separate estate; binding separate estate*

"The wife is a feme sole as to her separate estate, unless controlled by the settlement. Every restriction upon her power in it must be complied with. The wife may not bind that portion of her separate estate which is composed of tangible personal property by any contract of suretyship or by any assumption of the debts of her husband. The sale of any portion of her separate estate which is composed of tangible personal property to a creditor of her husband in extinguishment of his debts shall be absolutely void."

STATEMENT

The Winston Corporation, an Ohio corporation, brought suit against petitioner, Continental Casualty Company, an Illinois corporation, in the United States District Court for the Southern District of Ohio, Eastern Division, in 1970, seeking to recover asserted actual damages of $619,000 plus interest on a performance and payment bond dated October 3, 1967

furnished in Georgia by Continental, as surety for Diversified Engineering & Sales Corporation, as principal, to Winston, as obligee, respecting a contract of the same date between Winston and Diversified for construction of a nursing home in Atlanta, Georgia (App. E, *infra*, p. 1e). Diversity jurisdiction was determined properly to have been invoked (App. B, *infra*, p. 1b, 361 F. Supp. at 1024-1025).

Following trial in October 1972 before the court sitting without a jury, the District Court decided March 2, 1973 for Continental finding and concluding on two primary grounds that (1) an agreement of April 7, 1969 drafted and made by Winston and Diversified whereby the latter was relieved of further responsibility towards the construction of the King's Inn Nursing Home and all Diversified's subcontracts were assigned to Winston (which took over day by day responsibility for the construction) were material alterations made without the consent of Continental, were not permitted by the "addendums, modifications and amendments" clause of the bond,[1] and under Georgia law constituted a novation which discharged the surety,[2] and (2) Winston failed to comply with the notice provisions of the contract relative to default of Diversified (App. B, *infra*, p. 7b, 361 F. Supp. at 1027, 1028), the court also finding

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[1] App. E, *infra*, p. 1e, clause relating to plans and specifications.

[2] The court also found Diversified's role in the construction was effectively ended by the April 7th agreement which had little relationship to the contract as originally bonded by Continental (App. B, *infra*, p. 10b, 361 F. Supp. at 1028).

that the April 7th agreement was the functional equivalent of a declaration of default (App. B, *infra*, p. 6b, 361 F. Supp. at 1027). The trial court also found that Diversified had been paid by Winston approximately one half the contract price but had completed about one third of the construction work (App. B, *infra*, p. 4b, 361 F. Supp. at 1026).

In arriving at its judgment the District Court considered the suretyship statutes, Sections 103-202 and 103-203, Annotated Code of Georgia (*supra*, p. 3), a number of Georgia supporting appellate court decisions to the effect that any change in the terms of the contract is considered a novation and discharges the surety in the absence of its consent; that a surety is discharged by any act of the creditor which injures him or increases his risk; that Georgia draws no distinction between compensated and uncompensated sureties, and that a suretyship contract must be strictly construed in favor of the surety (App. B, *infra*, p. 9b, p. 13b; 361 F. Supp. at 1028 and 1030).

Upon Winston's motion for reconsideration, the District Court adhered to its original findings, conclusions and opinions under Georgia law (App. B, *infra*, p. 17b, 361 F. Supp. at 1031), declining to substitute its personal views for the established principles of the Georgia law of suretyship.

Accordingly, the District Court never reached any questions of damages or any other defenses than the two upon which its judgment was rendered.

Upon appeal by Winston, the Court of Appeals decided that the April 7, 1969 agreement did not discharge Continental and that the failure of Winston to comply with the notice provisions of Article 22 of the

contract did not excuse Continental from its obligation to indemnify Winston under the terms of the bond.

The Court of Appeals arrived at part of its decision by saying that under Georgia law a material change in the contract is considered a novation (App. A, *infra*, p. 6a, 508 F.2d at 1301).

The Court of Appeals also said, regarding the failure of Winston to give notice of default (citing *Erie Railroad v. Tompkins*, 304 U.S. 64 (1938)), that it applied the surety law of Georgia "as expressed either by its legislature or by its highest court." (App. A, *infra*, p. 7a, 508 F.2d at 1301.) Then the Court of Appeals said, "[A]nd in the absence of a dispositive statute or a controlling decision of the state's highest court, we apply what we determine to be the state law after giving proper regard to relevant precedents of the state."[3] (App. A, *infra*, p. 7a, 508 F.2d at 1302.)

The Court of Appeals had earlier recognized there was recent authority in Georgia which appeared to "support the application of the *stricti juris* rule even when the surety is compensated."[4] (App. A, *infra*, p. 8a, 508 F.2d at 1302.) The Court of Appeals then went on to say that the Supreme Court of Georgia had not, however, "definitively determined whether the distinc-

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[3]Citing *Commissioner v. Bosch*, 387 U.S. 456 (1967), a federal estate tax case in which the Court held federal authorities are not bound by the determination made of property interest by a state trial court, Justices Douglas, Harlan and Fortas dissenting.

[4]Citing *Brunswick Nursing & Convalescent Center, Inc. v. Great American Surety Co.*, 308 F. Supp. 297 (S.D. Ga. 1970), and *Peara v. Atlanta Newspapers Inc.*, 120 Ga. App. 163, 169 S.E.2d 670 (1969).

tion between compensated and uncompensated sureties applies in Georgia."

Later on, the Court of Appeals, after quoting Section 103-202 of the Annotated Georgia Code (*supra*, p. 3) to the effect that any change in the nature or terms of a contract is a novation which if made without the consent of the surety discharges him, said: "It is evident, however, that the Georgia legislature intended the sweeping provisions protecting sureties to apply only to uncompensated sureties." The Court of Appeals discerned such intent from the definition of suretyship in Section 103-101 (*supra*, p. 3), and drew from such section a conclusion "* * * that only uncompensated sureties were intended to benefit from this statutory protection and compensated sureties were to be treated as guarantors."[5] (App. A, *infra*, p. 10a, 508 F.2d at 1303.)

The Court of Appeals postulated that "[S]ince there is no authoritative expression of Georgia law, we may exercise our judgment based upon applicable principles of state law, upon relevant decisions in other jurisdictions, and upon our own conceptions of sound and just rules." (App. A, *infra*, p. 11a, 508 F.2d at 1304.) Then it remarked, "[W]e believe that the Georgia Supreme Court, if it were deciding this case, would follow recent authority and refuse to apply the outmoded *stricti juris* rule that some Georgia courts have stated is applicable to compensated sureties.

[5] The subsequent discussion of the Court of Appeals about suretyship of married women (App. A, *infra*, p. 10a, 508 F.2d at 1303) did not mention the pertinent and separate Georgia statute (53-503, *supra*, p. 4).

Instead, we believe the supreme court would determine that appellant's failure to give seven days notice was an unsubstantial breach in light of the circumstances of this case and that it caused no prejudice or injury to the surety." (App. A, *infra*, p. 12a, 508 F.2d at 1304.)

Accordingly, proceeding as above outlined, the Court of Appeals declined to follow Georgia law, reversed the judgment of the trial court, and remanded the case for entry of judgment for Winston (App. D, *infra*, pp. 1d, 2d).

The Court of Appeals did not say or hold that any finding of the District Court was clearly erroneous.

REASONS FOR ALLOWANCE OF THE WRIT

Solely by virtue of the diversity statute was this case in a federal court at all. The source of the rights of the parties was in Georgia. The parties and both courts below agreed that Georgia law governed. No competing federal interest existed.

Section 34 of the Judiciary Act of September 24, 1789 and the revision thereof, now 28 U.S.C. 1652, substantially the same, established a policy crucial to the balance between state-national relationships in the light of the underlying premises of our dual form of government.

In this setting the inquiry is, Who is to make the Georgia law – the United States Court of Appeals for the Sixth Circuit, which has no nexus with Georgia, or

the Georgia legislature and its courts? The Rules of Decision Act gives the clear and unmistakable response.

Both 28 U.S.C. 1652 and *Erie*, including subsequent applicable cases of this Court,[6] make it clear that in this pure diversity case neither the Acts of the Georgia Legislature nor its appellate court decisions may be disregarded or by-passed so as to permit a federal court, trial or appellate, to amend, modify or abridge governing legislative acts directly embracing the subject of the law suit or to displace pertinent state appellate judicial decisions, thus creating its own vacuum which it may proceed to fill at will.[7]

Georgia has enacted statutes defining suretyship, expressly stating in plain terms that the contract of suretyship is one of strict law and the liability of the surety is not to be extended by implication or interpretation; that any change in the nature or terms of a suretyship contract is called a novation which, in the absence of consent, discharges the surety, and that any act of the creditor either before or after judgment against the principal which injures the surety or increases his risk shall work a discharge of the surety.

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[6] *Erie Railroad Co. v. Tompkins*, 304 U.S. 64 (1938); *Fidelity Union Trust Co. v. Field*, 311 U.S. 169 (1940); *Six Companies of Cal. v. Highway Joint Dist.*, 311 U.S. 180 (1940); *Guaranty Trust Co. v. York*, 326 U.S. 99 (1945); *Gooding v. Wilson*, 405 U.S. 518, 526 footnote 3 (1972).

[7] "We think that the law thus announced and applied is the law of the state applicable in the same case and to the same parties in the federal court and that the federal court is not free to apply a different rule however desirable it may believe it to be, and even though it may think that the state Supreme Court may establish a different rule in some future litigation." *West v. AT&T Co.*, 311 U.S. 223, 238 (1940).

There is nothing in any of those statutes which differentiates between a compensated and an uncompensated surety. Under the Rules of Decision Act those statutes should be accepted by a federal court in a pure diversity case unless and until authoritative court decisions of the state have established the law of Georgia that such statutes do not apply to a compensated surety. In a carefully written opinion the District Court applied both 28 U.S.C. 1652 and Georgia statutory and decisional law in arriving at its judgment. The Court of Appeals did just the opposite, by saying and holding that in the absence of a Supreme Court of Georgia decision holding that the Georgia suretyship statutes did apply to a compensated surety it was free to hold that they did not apply. No Georgia decision was or could be pointed to which held that such suretyship statutes did not apply to Continental's suretyship.

In *Gooding v. Wilson*, 405 U.S. 518, 526 footnote 3 (1972), this Court stated that the Court of Appeals of Georgia, being a court of state-wide jurisdiction, the decisions of which are binding on all trial courts, would be followed by the federal courts in the absence of a conflicting decision by the Supreme Court of Georgia.

The assertion of the Court of Appeals that the statutory definition of suretyship (Section 103-101) made it plain compensated sureties were to be treated as guarantors and were not intended to benefit from any other of the suretyship statutes of Georgia, and specifically Section 103-202 (App. A, *infra*, p. 10a, 508 F.2d at 1303), was unsupported, supplanted the policy in the cluster of Georgia suretyship statutes, and was contrary to the Georgia decisions.

From those cases and an inspection of the recitals and condition of Continental's bond (App. E, *infra*, p. 1), signed by Diversified, as principal, and by Continental, as surety, in which each was primarily liable to the obligee, it is beyond cavil that Continental's bond was one of suretyship; that additional consideration flowing to the surety, i.e., a premium for writing of the bond, did not alter the nature of the instrument, and that the Georgia rule of *stricti juris* is applicable both to a contract of guaranty and of suretyship. *Guaranty Mortgage Co. of Atlanta v. National Life Insurance Co.*, 55 Ga. App. 104, 189 S. E. 603 (1936), aff'd 184 Ga. 644, 192 S. E. 298 (1937); *Durham v. Greenwold*, 188 Ga. 165, 167, 3 S. E. 2d 585, 586 (1939); *Nichols v. Miller*, 91 Ga. App. 99, 101, 84 S. E. 2d 841 (1954); *LeCraw v. Atlanta Arts Alliance*, 126 Ga. App. 656, 191 S. E. 2d 572 (1972); Uniform Commercial Code, Ann. Code of Georgia, Section 109A-1-201(40) – defining "surety" to include guarantor.

The Georgia appellate decisions have made no distinction in regard to the Georgia suretyship statutes between compensated and uncompensated sureties. Indeed, that was recognized by the Court of Appeals in its opinion (App. A, *infra*, p. 8a, 508 F.2d at 1302). Examination of cases cited in both the opinion of the District Court and that of the Court of Appeals and of other Georgia decisions shows that the Georgia *stricti juris* suretyship statutes have been applied indiscriminately both as to corporate sureties in the bonding business and to other sureties. *Savannah Lighting Co. v. Fidelity and Deposit Co. of Md.*, 21 Ga. App. 758(2), 95 S.E. 113 (1918); *Paulk v. Williams*, 28 Ga. App. 183, 110 S. E. 632 (1922); *Maryland Cas. Co. v. McAlpin*,

31 Ga. App. 303(1), 120 S. E. 644 (1923); *Mauny v. Hartford Accident & Indemnity Co.*, 68 Ga. App. 515, 23 S. E. 2d 490 (1942); *Mayor & Aldermen of the City of Savannah v. Glen Falls Ins. Co.*, 104 Ga. App. 879, 123 S. E. 2d 293 (1961); *Jenkins v. Gordy, et al.*, 105 Ga. App. 255, 124 S. E. 2d 303 (1962); *Palmes v. Southern Mechanical Co., et al.*, 117 Ga. App. 672, 161 S. E. 2d 413 (1968); *Peara v. Atlanta Newspapers, Inc.*, 120 Ga. App. 163, 169 S. E. 2d 670 (1969); *Brunswick Nursing & Convalescent Center v. Great America Insurance Co.* (E. D. Ga.), 308 F. Supp. 297, 299-300 (1970); *LeCraw v. Atlanta Arts Alliance, supra* (1972).

As to the effect of alteration by Winston and Diversified of the contract in their April 7, 1969 agreement and in overpayment (*supra*, pp. 5 and 6) without the consent of Continental, the surety, the Court of Appeals again failed to govern itself by the Rules of Decision Act and to apply Georgia law. Aside from Georgia suretyship statutes and decisions above cited respecting discharge of the surety by changes in the contract, Georgia courts have specifically over the years been consistent as to the effect of unconsented to alterations or amendments. Thereunder, it is not for the parties to the contract to decide that their alteration or amendment of the contract without the consent of the surety increases or does not increase the risk of the surety or is for his benefit. The surety has the right to determine for himself whether he thinks those alterations are material or immaterial. *Bethune v. Dozier*, 10 Ga. 235, 241 (1851); *Taylor v. Johnson*, 17 Ga. 526, 534 (1855); *Alropa Corporation v. Snyder*, 182 Ga. 305, 315, 185 S. E. 352, 358 (1936); *LeCraw v.*

Atlanta Arts Alliance, Inc., supra.[8]

Every aspect of the opinion of the Court of Appeals is contrary to governing Georgia statutory and decisional suretyship law,[9] standing athwart the Rules of Decision Act and applicable decisions of this Court (footnote 6, *supra*, p. 10). In the face of the Georgia suretyship statutes and of the Georgia appellate decisions thereunder, the Court of Appeals could not correctly use its asserted absence of a decision of the highest court of Georgia as a means of legislating for Georgia solely on a state matter. Long before *Erie*, this Court had uniformly considered that Section 34 of the Judiciary Act of September 24, 1789 applied "to the positive statutes of the State, and the construction thereof adopted by the local tribunals, * * *." *Swift v. Tyson*, 16 Peters 1, 18 (1842). The way of looking at Georgia decisional law by the Court of Appeals was that of the Federal Courts prior to *Erie* and to *Guaranty Trust Co. v. York, supra*, now outmoded and disapproved.[10]

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[8]General law is to same effect. *Reliance Insurance Co. v. Colbert*, 124 U.S. App. D.C. 339, 343, 365 F.2d 530, 534 (1966); *Bopst v. Columbia Casualty Co.*, 37 F. Supp. 32, 34 (1940).

[9]The discussion by the Court of Appeals relative to suretyship of married women seems wholly irrelevant to the issues on appeal. A different Georgia statute pertains to such suretyship– Section 53-503, *supra*, p. 4, Cf. *Judson v. Duran*, 231 Ga. 205, 200 S.E.2d 782 (1973).

[10]"Law was conceived as a 'brooding omnipresence' of Reason, of which decisions were merely evidence and not themselves the controlling formulations. Accordingly, federal courts deemed themselves free to ascertain what Reason, and therefore Law, required wholly independent of authoritatively declared State law, even in cases where a legal right as the basis for relief was created by State authority and could not be created by federal authority and the case got into a federal court merely because it was 'between Citizens of different States' under Art. III, § 2 of the Constitution of the United States." *Guaranty Trust Co. v. York, supra* (326 U.S. at 102).

The Court of Appeals, in failing to apply Georgia suretyship law – statutory and decisional – and in remaking both, has also failed to abide by and properly to apply the Rules of Decision Act, which "has practical aspects of great importance in the proper administration of justice in the federal courts." *Fidelity Union Trust Co. v. Field, supra* (311 U.S. at 179). The Court of Appeals likewise failed to follow *Erie* and the subsequent decisions of this Court on 28 U.S.C. 1652. The matter is one of continuing and recurring significance in maintaining the balance between state and federal relationships.

CONCLUSION

In view of the foregoing, it is respectfully submitted that the petition for a writ of certiorari should be granted.

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APPENDIX A

No. 73-1886

UNITED STATES COURT OF APPEALS

FOR THE SIXTH CIRCUIT

THE WINSTON CORPORATION,
Plaintiff-Appellant,
v.
CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee.

ON APPEAL from the United States District Court for the Southern District of Ohio, Eastern Division.

Decided and Filed January 17, 1975.

Before: WEICK and McCREE, Circuit Judges, and CONTIE,* District Judge.

McCREE, Circuit Judge. This is an appeal from a judgment in a diversity action for defendant-appellee on a performance and payment bond executed by Continental Casualty Company, as surety, in favor of appellant, The Winston Corporation, as obligee. The parties agree that Georgia law applies.

The facts of the case are virtually undisputed. In 1967, Diversified Engineering and Sales Corporation (Diversified) agreed to build for The Winston Corporation (Winston) a nursing home at a cost of $752,874.00. The construction contract required Diversified to obtain a performance and payment bond from an acceptable bonding company. Diversified purchased a bond from Continental Casualty Company (Con-

* The Honorable Leroy J. Contie, Jr., Judge, United States District Court for the Northern District of Ohio, sitting by designation.

tinental) for a premium of $6,444.00. A copy of the bond, drafted by Continental on its own printed form, was delivered to Winston on October 3, 1967.

The bond expressly incorporated the provisions and specifications of the construction contract and provided, *inter alia*:

> NOW, THEREFORE, THE CONDITION OF THE ABOVE OBLIGATION IS SUCH, that if the above bounden Principal shall well and faithfully perform the things agreed by him to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall pay all persons who have furnished labor or material for use in or about the improvement; and shall indemnify and save harmless the Obligee, and its officers, agents and employees, from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract; then, this obligation shall be null and void, otherwise, the same shall remain in full force and effect.

Continental issued the bond without reading the construction contract and never even requested a copy of it until approximately two and one-half years later. Continental did, however, investigate the financial condition of Diversified and its principal before it issued the bond. It learned that Diversified had comparatively thin assets, a not uncommon condition for some construction companies, but that Diversified's principal was financially stable. Before construction began several weeks later, however, Continental discovered that Diversified's principal was suffering a serious financial setback and that he would no longer be participating in the project. Continental did not object to his withdrawal, and accepted another officer of Diversified as a substitute, even though he had submitted to Continental financial statements overstating his own and Diversified's net worth.

Continental never communicated any of this unfavorable financial information to Winston.

On December 4, 1967, Winston obtained a construction loan for which it executed a $1,250,000.00 promissory note and security deed. On December 11, the construction lender, the permanent lender, and Winston agreed that the permanent lender would purchase the loan from the construction lender upon completion of the project.

On the next day, Winston instructed Diversified to begin construction in accordance with their contract which provided that the project be completed within 300 calendar days after commencement of construction.

Shortly thereafter, construction began with completion scheduled for mid-October 1968. Upon expiration of the 300 day period, however, the building was far from finished despite Winston's repeated exhortations. Continental watched closely the developments at the construction site and was fully aware of the construction delays and problems. In addition, Continental had initiated a lawsuit against Diversified in that same year for non-performance of another construction contract and eventually obtained a favorable judgment.

After the scheduled completion date had passed, Winston officials met with Diversified in January and again in April 1969. In April, the project was still not finished even though more than five months had elapsed since the scheduled completion date. Continental was asked on more than one occasion to attend these meetings convened to resolve construction delays and problems. The surety, however, refused to attend. During discovery proceedings, Winston learned that Continental, as early as April 1968, shortly after construction had begun, had discussed denying that the bond was still in force. These discussions were not communicated to Winston.

In early spring of 1969, Winston faced the following crisis: the construction loan was about to mature; the permanent loan commitment was about to expire; and no progress was being

made on the project. Accordingly, on April 7, 1969, after an earlier meeting to which Continental had been invited but refused to attend, Winston and Diversified entered into a letter agreement designed to accelerate construction. This agreement, intended as an assignment of the construction contract, permitted Winston to take possession of the premises, to assume construction of the project, and to take an assignment of Diversified's subcontracts and other rights. It specifically contemplated, however, Diversified's continuing participation in the contract. Moreover, one of its provisions stated that the agreement "does not modify or change the existing bond on the project which exists for the owner's benefit." The agreement, considered to be the most efficacious method of completing construction at the lowest cost and with the least delay, was believed to be authorized by Contract Article 33 governing assignment.

On the same day, April 7, 1969, Diversified notified Continental by telephone of the letter agreement and mailed a copy of it. Within a few days, Winston took over construction of the nursing home, and it was completed in mid-October 1969, approximately twelve months after the scheduled completion date. Winston took possession of the premises and began nursing operations a month later.

In December 1969, Winston submitted a claim to Continental on the performance and payment bond. When Continental refused to honor the bond, Winston brought this action in United States District Court on June 18, 1970.

The amended complaint alleged that the performance and payment bond had been executed by Continental to guarantee performance of the construction contract between Winston and Diversified; that the construction contract required Diversified to furnish all labor and materials for the construction of a nursing home in Georgia in accordance with certain plans and specifications; that Diversified had failed

to do so; and that Continental had failed to honor the bond it issued in connection with the project. It also alleged that Continental had acted tortiously toward Winston by failing to relay to Winston information it learned concerning Diversified's precarious financial condition.

In 1972, the case was tried before the district court sitting without a jury. Its decision was issued on March 2, 1973, and judgment was entered in favor of Continental. After a motion for reconsideration was denied, notice of appeal was filed on June 19, 1973.

In its opinion, the district court determined that Winston could not recover on the performance and payment bond because (1) the April 7 agreement was a novation of the construction contract that had the effect of discharging the surety in the absence of the surety's consent; and (2) the failure of Winston to give Continental seven days written notice under Article 22 before terminating the employment of the contractor released Continental from its obligations on the bond. In addition, the court determined that Winston could not recover damages on either a common law tort or contract theory.

On appeal, Winston contends that the district court erred in concluding that the April 1969 agreement was a novation that discharged Continental, and argues further that if it were a novation, Continental consented to it in advance and therefore is not discharged. It also argues that even if it were a novation to which Continental did not consent, Continental, as a compensated surety, is not discharged because the novation was not actually detrimental to its interests. Further, Winston contends that the district court erred in denying recovery to it because of failure to comply strictly with the notice provisions of Article 22 of the construction contract. Finally, it contends that the district court erred in holding that Winston did not have a valid claim against Continental on common law tort and contract theories.

An examination of the opinion filed by the district court, of the briefs and record filed in connection with the appeal, and of Georgia law, convinces us that whether the April 7 agreement is interpreted as an assignment or as a termination of the contract, it did not discharge the surety. We also determine that the failure of Winston to comply strictly with the notice provisions of Article 22 did not excuse Continental from its undertaking to indemnify Winston under the bond. Accordingly, we need not decide the other assignment of error.

Under Georgia law, a material change in the terms of a contract is considered a novation and discharges a surety. *Brunswick Nursing & Convalescent Center, Inc.* v. *Great American Insurance Co.*, 308 F.Supp. 297, 299-300 (S.D. Ga. 1970); *American Surety Co. of New York* v. *Garber*, 114 Ga. App. 532, 151 S.E.2d 887 (1966).

In this case, the construction contract, which was expressly incorporated in the bond, permitted both an assignment[1] of the contract and its termination under specified circumstances. Article 22, "OWNER'S RIGHT TO TERMINATE CONTRACT," provided, in relevant part,

> If the Contractor should . . . persistently or repeatedly refuse or should fail, except in cases for which extension of time is provided, to supply enough properly skilled workmen or proper materials, . . . or otherwise be guilty of a substantial violation of any provision of the Contract, then the Owner . . . may, without prejudice to any other right or remedy and after giving the Contractor, and his surety, if any, seven days written notice, terminate the employment of the Contractor and take possession of the premises and of all materials, tools and appliances thereon and finish the work by whatever method he may deem expedient.

[1] The assignment article of the contract provides:
ASSIGNMENT
Neither party to the Contract shall assign the Contract or sublet it as a whole without the written consent of the other, nor shall the Contractor assign any moneys due or to become due to him hereunder, without the previous written consent of the Owner.

By the very terms of the contract to which Continental agreed, Winston had an absolute right to terminate the employment of the contractor and to assume the construction of the home itself. Accordingly, even if the April 7 agreement be considered a termination of the contract, it was not a novation since it was contemplated by the terms of the contract. Instead, it was an implementation of one of the contract provisions. Winston, by the April 7 agreement, merely undertook to do that which Diversified had promised, but failed to do.

The next question is whether Continental was discharged from its obligation because Winston failed to give it written notice seven days in advance of taking over the construction. In deciding this question, we apply the surety law of the State of Georgia as expressed either by its legislature or by its highest court. *Erie Railroad* v. *Tompkins*, 304 U.S. 64 (1938). And, in the absence of a dispositive statute or a controlling decision by the state's highest court, we apply what we determine to be the state law after giving proper regard to relevant precedents of other courts of the state. *Commissioner* v. *Estate of Bosch*, 387 U.S. 456 (1967).

Historically, an alteration of the primary obligation owed to the obligee discharged the surety. *Bethune* v. *Dozier*, 10 Ga. 235, 238-39 (1851), 10 Williston, *Contracts*, § 1240 (rev. ed. 1917). The obligation of a surety was considered *stricti juris*, and even a slight deviation from the contract terms discharged the surety. The results of applying this rule were often harsh and unjust, especially when compensated sureties were relieved of their obligations because of technical breaches of the assured contract. Consequently, most courts departed from the rule of *stricti juris* in cases in which a surety had been compensated for its undertaking and developed the rule that a compensated surety is discharged only if the change is material and causes some injury, loss,

or prejudice to it. *See Montpelier* v. *National Surety Co.*, 97 Vt. 111, 122 A. 484, 33 A.L.R. 489 (1923), *School District* v. *Massachusetts Bonding & Ins. Co.*, 92 Kan. 53, 142 P. 1077 (1914), *Bross* v. *McNicholas*, 66 Or. 42, 133 P. 782 (1913), Annot., 127 A.L.R. 10, 62-63 (1940), Annot., 12 A.L.R. 382 (1921), Note, 33 Tulane L. Rev. 717 (1959).

Although most jurisdictions now differentiate between compensated and uncompensated sureties for the purpose of determining contractual liability, there is recent authority in Georgia that appears to support the application of the *stricti juris* rule even when the surety is compensated. *Brunswick Nursing & Convalescent Center, Inc.* v. *Great American Surety Co., supra, Peara* v. *Atlanta Newspapers, Inc.*, 120 Ga. App. 163, 169 S.E.2d 670 (1969).

The Georgia Supreme Court has not, however, definitively determined whether the distinction between compensated and uncompensated sureties applies in Georgia. Appellant has cited only two cases decided by the Supreme Court of Georgia in which the question of discharge of a surety has been discussed, and appellee has cited none. Neither case is dispositive. *Zellner* v. *Hall*, 210 Ga. 504, 80 S.E.2d 787 (1954) and *Alropa Corp.* v. *Snyder*, 182 Ga. 305, 185 S.E. 352 (1936) stand only for the proposition that a surety is discharged by an act of his principal or obligee that increases its risk unless it consents to the novation. They do not hold that a compensated surety is discharged by a change in the contract that does not increase the risk it has assumed.

In other instances, although the Georgia Supreme Court has spoken in terms of *stricti juris* in considering the liability of sureties, it has refused to give effect to unreasonable terms in surety contracts and has applied equitable principles in order to achieve just results. Thus, in *Waldon* v. *Maryland Casualty Co.*, 155 Ga. 76, 116 S.E. 828 (1923), the court considered the effect of the failure of the obligee to comply strictly with contract provisions for service of process on the

surety in an action on the bond. The pertinent portion of the contract stated:

> Provided, however, that this bond is executed upon the following express conditions, the performance of each of which shall be condition precedent to any right of recovery hereon, anything in the contract to the contrary notwithstanding . . . 2. That no claim, suit, or action by reason of any default shall be brought against the principal or surety after the 18th day of March, 1916, nor shall recovery be had for damages accruing after that date; that service of writ or process commencing any such suit or action shall be made on or before such date . . . .

155 Ga. at 80. Service of process on the surety was not perfected until March 30, 1916, although the suit was filed before March 18. The court refused to construe the contract terms strictly and held that service on the surety company related back to the filing of the suit. It held that any other interpretation of the contract would empower court officers to prevent recovery by delaying service of process. Because the contract in *Waldon* stated that service of process before a certain date was a condition precedent to the surety's liability, the court's decision to hold the surety liable when the action was timely commenced evidences a policy of the Georgia Supreme Court to avoid an injustice that would result from giving effect to a technical breach of a contract of suretyship. And the Georgia Supreme Court applied equitable principles in an action against a surety who was not permitted to claim the rule of *stricti juris* when his own actions contributed to the default. *Jones* v. *Hawkins*, 60 Ga. 52 (1878).[2]

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[2] In this case an attorney had acted as surety for his client and procured a discharge in bankruptcy. The attorney asserted that the bankruptcy adversely affected the risk he undertook. The court held: "Whilst there is nothing immoral in what [surety] did as counsel, yet he does not come into court in such manner as entitles him to claim *stricti juris* as his measure of right." 60 Ga. at 56.

Since *Erie* directs our attention to the statutes of the state as well as its high court decisions, we consider 28A Georgia Code Annotated, section 103-202, which provides:

> Any change in the nature or terms of a contract is called a novation; such novation, without the consent of the surety, discharges him.

It is evident, however, that the Georgia legislature intended the sweeping provisions protecting sureties to apply only to uncompensated sureties. The very first section of the surety statute defines a contract of suretyship as

> . . . one whereby a person obligates himself to pay the debt of another in consideration of credit or indulgence, or other benefit given to his principal, the principal remaining bound therefor. It differs from a guaranty in this, that the consideration of the latter is a benefit flowing to the guarantor.

28A Ga. Code Ann. § 103-101.

The plain meaning of this section is that only uncompensated sureties were intended to benefit from this statutory protection and compensated sureties were to be treated as guarantors.

The statute has been so applied in cases where married women seek to bind their separate estates to secure the extension of credit to third persons. In Georgia, married women may not act as sureties and bind their separate estates but may act as guarantors. The determinative factor in deciding whether a married woman has agreed to act as a surety or as a guarantor is whether she has received "new, separate and independent" consideration for the undertaking. If she did not, she is a surety, for the purpose of the statute, and her separate estate is not bound by her undertaking. *See, e.g., Southern Land & Development Co.* v. *Silvers,* 499 F.2d 967 (6th Cir. 1974), *Wolkin* v. *National Acceptance Co.*, 222 Ga. 487, 150 S.E.2d 831 (1966). Nevertheless, a third person, not a married woman, who obligates himself to pay the seller of goods in consideration of credit extended to a purchaser has, in Georgia, uniformly been considered a guarantor even through he receives no independent consideration.

In cases other than those concerning the power of married women to bind their separate estates and concerning the extension of credit to the purchaser of goods, the line of demarcation between sureties, who are said to be favorites of the law, and guarantors, who are said not to be, is not clear despite the statutory definition of those terms. However, we observe that in none of the cases cited by the parties has a compensated surety been discharged because of the failure of its obligee to comply strictly with a provision of the assured agreement unless the departure from its terms increased the surety's risk or changed the contract to the surety's detriment. *See, e.g., Alropa Corp.* v. *Snyder, supra, Hill* v. *O'Neill,* 101 Ga. 832, 28 S.E. 996 (Ga. 1897), *Peara* v. *Atlanta Newspapers, Inc., supra, Palmes* v. *Southern Mechanical Co.*, 117 Ga. App. 672, 161 S.E.2d 413 (1968), *Mayor & Aldermen of the City of Savannah* v. *Glen Falls Insurance Co.*, 104 Ga. App. 879, 123 S.E.2d 293 (1961), *cf. American Surety Co. of New York* v. *Garber,* 114 Ga. App. 532, 151 S.E.2d 887 (1966).

From our review of the statutes and case law, we conclude, as many of the Georgia courts of appeals have, that the law of suretyship in Georgia is unsettled, and often contradictory. *E. g., General Finance Corp. of Atlanta, Northeast* v. *Welborn,* 98 Ga. App. 280, 105 S.E.2d 386 (1958), *Etheridge* v. *W. T. Rawleigh Co.*, 29 Ga. App. 698, 116 S.E. 903 (1923), *A. B. Small Co.* v. *Claxton,* 1 Ga. App. 83, 57 S.E. 977 (1907). Since there is no authoritative expression of Georgia law, we may exercise our judgment based upon applicable principles of state law, upon relevant decisions in other jurisdictions, and upon our own conceptions of sound and just rules. *E. g., Putnam* v. *Erie City Manufacturing Co.*,

338 F.2d 911 (5th Cir. 1964), *New England Mutual Life Insurance Co.* v. *Mitchell,* 118 F.2d 414 (4th Cir.) *cert. denied,* 314 U.S. 629 (1941).

We believe that the Georgia Supreme Court, if it were deciding this case, would follow recent authority and refuse to apply the outmoded *stricti juris* rule that some Georgia courts have stated is applicable to compensated sureties. Instead, we believe the supreme court would determine that appellant's failure to give seven days notice was an insubstantial breach in light of the circumstances of this case, and that it caused no prejudice or injury to the surety.

Under modern American surety law, a mere technical breach of a surety contract, not resulting in damage or prejudice to the surety, will not release it from its obligations.[3] *Montpelier* v. *National Surety Co.,* 97 Vt. 111, 122 A. 484, 33 A.L.R. 489 (1923), *Doyle* v. *Faust,* 187 Mich. 108, 153 N.W. 725 (1915), *School District* v. *Massachusetts Bonding & Ins. Co.,* 92 Kan. 53, 142 P. 1077 (1914), *Bross* v. *McNicholas,* 66 Or. 42, 133 P. 782 (1913), Annot., 127 A.L.R. 10, 62-63 (1940), Annot., 12 A.L.R. 382 (1921), Simpson, *Suretyship* 111 (1950). This is the situation here. In the bond it executed for the benefit of Winston, Continental agreed, for a substantial consideration, that the bond would "remain in full force and effect" until the principal, Diversified,

> shall well and faithfully perform the things agreed by him to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall indemnify and save harmless the Obligee, and its officers, agents and employees, from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract . . . .

[3] We observe here that Louisiana has surety statutes similar to those of Georgia, and Louisiana courts have given literal effect to the statutes' terms. Art. 2198 of the Louisiana Civil Code provides that "the novation that takes place with regard to the principal debtor discharges the surety," and is similar to section 103-202 of the Georgia Code. Art. 3061 of the Louisiana Civil Code provides that any act of the obligee which is prejudicial to the rights of the surety discharges it. This provision is similar to section 103-203 of the Georgia Code. Originally, Louisiana courts made no distinction between accommodation sureties and compensated sureties, but a more realistic approach was taken in *Texas & Pacific R.R.* v. *United States Fiduciary & Guaranty Co.,* 16 So.2d 671 (La. App. 1944), where strict construction of surety contracts was limited to accommodation sureties.

Moreover, when Continental executed the bond, or shortly thereafter, it was aware of the precarious financial condition of Diversified and of its failure to perform another construction contract to which Continental had acted as surety. Continental kept itself informed of the progress of construction of the nursing home and was aware of the delays and difficulties that finally led to the April 7 agreement. Continental was invited to discuss construction problems with Diversified and Winston several times but declined to attend any meeting including the one on April 7.

Had the April 7 agreement provided that it would not become effective until seven days after receipt by Continental, there is no doubt that Continental would not have been discharged. We do not believe that this insignificant distinction, in light of Continental's knowledge of the construction problems and its rejection of Winston's repeated invitations to discuss them, should require a different result.

Reversed and remanded for entry of judgment for appellant.

APPENDIX B

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
JOHN D. LYTER, CLERK

U.S. DISTRICT COURT
SOUTHERN DIST. OHIO
EAST. DIV. COLUMBUS

THE WINSTON CORPORATION,
Plaintiff

v. Civil No. 70-179

CONTINENTAL CASUALTY
COMPANY,
Defendant

OPINION AND ORDER

The Winston Corporation, an Ohio corporation, brings this action against Continental Casualty Company, a company organized under the laws of Illinois, on a performance and payment bond issued by Continental as surety for Diversified Engineering and Sales Corporation. The Court's diversity jurisdiction has been properly invoked under 28 U.S.C. §1332 and the

amount in controversy exceeds $10,000.00. The parties are in agreement that the law of Georgia will control the decision of this Court. This matter has now been submitted following trial to the Court, on the evidence, exhibits, stipulations and briefs of the parties.

This suit emerges from Winston's efforts to construct, between 1967 and 1969, the King's Inn Nursing Home in Atlanta, Georgia. While Winston and several of its principal officers had some experience in the construction field, primarily in residential housing, the decision to construct this nursing home represented a major and novel commitment of the corporation's resources. By the end of the summer of 1967, it had tentatively arranged for construction loans and commitments from banks in Atlanta, Georgia, and Rochester, New York. Bids were then let and three general contractors including Diversified Engineering and Sales Corporation of Atlanta, Georgia, bid on the project. The three bids came in at approximately $900,000.00 but after further negotiations, Winston entered into a contract with Diversified dated October 3, 1967, whereby Diversified agreed to build the nursing home for $752,874.00 in accordance with plans, specifications and subcontracts attached to that document. The term of the contract provided for completion of the structure within three hundred (300) days from the time construction commenced.

As a further condition to the contract of October 3, 1967, Diversified agreed to supply a performance and payment bond for the benefit of Winston as obligee. This bond was executed on October 3, 1967, between Diversified, as principal, and Continental, as surety, and by its express terms incorporated the provisions and

specifications of the contract of the same date.[1] Before it authorized the bonding of the nursing home project, Continental investigated the financial condition of Diversified and its principals, David W. Knight and Vance Dyer. This investigation revealed that while Diversified's assets, like those of many construction companies, were comparatively thin, its principal Knight appeared quite substantial and on this basis Continental accepted the risk of bonding the project.

Prior to the commencement of construction in January, 1968, Continental discovered that Knight was suffering financial ruin and would no longer be participating in the construction of the nursing home. Continental did not object in any form to Knight's withdrawal from the project and accepted Dyer as chief officer of Diversified in his place. It made no effort, however, to inform Winston of the data it had uncovered during its prebonding investigations, which revealed the less than solid financial condition of both Diversified and Dyer. Neither did Continental disclose to Winston that Diversified and Dyer had submitted

[1] The obligations of Continental under the bond of October 3, 1967, were as follows:

> "... [I]f the above bounden principal [Diversified] shall well and faithfully perform the things agreed ... to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall pay all persons who have furnished labor or material for use in or about the improvement; and shall indemnify and save harmless the obligee [Winston] ... from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract; then, this obligation [in the amount of $752,874.00] shall be null and void, otherwise, the same shall remain in full force and effect."

financial reports which overstated their actual net worth. Continental did not, at any time, suggest that Knight's departure from the project altered their obligations under the bond of October 3, 1967.

Construction work on the nursing home finally commenced in January of 1968 and proceeded disastrously almost from the outset. Under pressure from the municipal authorities, Diversified found it necessary to move the entire site of the project ten feet from where it had expected to build it; and problems having to do with the foundation of the nursing home were also encountered. By the late spring and summer of 1968 it became obvious to everyone connected with the project that construction of the nursing home had fallen hopelessly behind schedule. Despite increased exhortations from Winston and its agents, Diversified was unable to maintain a construction pace reasonably calculated to yield a completed structure at the expiration of the 300-day term. In August, 1968, for example, 70% of the term had elapsed but the structure was only 28% completed. A new certifying architect was brought in at that time in an effort to impose firmer control on the course of the construction.

By the summer of 1968 it had also become obvious to all interested observers that there was little correlation between the percentage of completed structure and the percentage of depleted construction funds. In the middle of September, 1968, for example, approximately one-third of the building was completed but approximately one-half of the contract price had been expended for that portion of the construction.

Continental followed developments at the construction site closely and its agents prepared a

continuous stream of memoranda about the position the company should take were a claim filed under the bond. Some of Continental's agents were of the opinion that the bond was not in legal force because of Winston's alleged failures to abide by Article 8.3 of the contract; others argued in memos to the home office that Continental was discharged from its obligations because of a change made in the manner of disbursements in January, 1968, by the lending bank in Atlanta. There is no evidence, however, that Continental firmly decided on a legal course of action prior to the time that a claim was actually made upon the bond in December, 1969.

The 300-day term of the contract expired by November, 1968. Winston, in an effort to clarify its exposure, called for a meeting of the three parties to the surety contract in January, 1969. The company was concerned, as its deadline for closing the permanent loan was April 1, 1969, and because it had already entered into a lease with River City Corporation for the completed nursing home. Continental declined to attend this meeting, indicating somewhat cryptically that it would proceed in accordance with its obligations under the bond. The surety refused, however, to give Winston any opinion on the effect further delay in the construction of the nursing home would have on the continued validity of the bond.

Events reached their climax in April, 1969, with Winston bringing things to a head. It requested a meeting among the three parties in Atlanta, but Continental refused to attend. After negotiations on April 3, 1969, Winston decided to terminate, pursuant to Article 22 of the General Conditions of the

Contract,[2] Diversified's participation in the construction of the nursing home. Diversified reacted to this move by threatening legal action and after further negotiations the parties entered into an agreement dated April 7, 1969. By its terms Diversified was relieved of further responsibility towards the construction of the King's Inn Nursing Home. All of its contracts with the project's subcontractors were assigned to Winston, which took over day by day responsibility for the construction. While the documents drafted by Winston and Diversified do not directly state that the contractor was in default under the contract, the agreement of April 7th constituted the functional equivalent of a declaration of default. Although Winston vigorously denied that this was the intent of the parties, the effect of these negotiations leads inescapably to our present conclusion. It is undisputed that Continental was not

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[2] Article 22, of the Contract, provides in material part as follows:

> "*Owner's Right to Terminate Contract* – If the Contractor should be adjudged a bankrupt, . . . or if he should fail to make prompt payment to subcontractors or for material or labor, or persistently disregards laws, ordinances or the instructions of the Architect, or otherwise be guilty of a substantial violation of any provision of the Contract, then the owner, upon the certificate of the Architect that sufficient cause exists to justify such action, may, without prejudice to any other right or remedy and after giving the Contractor, and his surety, if any, seven days written notice, terminate the employment of the Contractor and take possession of the premises and of all materials, tools and appliances thereon and finish the work by whatever method he may deem expedient . . . ."

given the seven days written notice of plaintiff's intent to default Diversified as was required by Article 22.

With Winston in direct charge of the project, things began to proceed more smoothly. An extension of the bank loans was negotiated and while the original lease for the nursing home was terminated, a new one, albeit at less favorable terms, was entered into. Under Winston's control the nursing home project was completed on October 24, 1969, at a total cost of $1,018,000.00. After Continental refused, in December, 1969, to recognize any liability under the bond, Winston brought the present action to recover actual damages in the amount of approximately $619,000.00 plus interest. This amount represents the additional construction costs over and above the contract price; increased interest on the extension of the permanent loan and the construction loan; and the loss of rental income due to Winston's inability to perform on its lease with River City Corporation. In addition, Winston is seeking to recover punitive damages against Continental for its alleged failure to comply in good faith with the terms of the bond and for the surety's failure to make financial information concerning Diversified available to Winston.

On the state of facts as set forth above, this Court is of the opinion that judgment must be entered in favor of the surety. Our holding is based on two primary grounds: that the agreement entered into between Winston and Diversified on April 7, 1969 constituted a novation of the original contract which, under principles of Georgia law, discharged the surety; and on the further ground that Winston failed to abide by the notice provisions of Article 22 of the Contract, see n.2

supra. We believe that certain other contentions advanced by the parties are without legal merit.[3] These legal conclusions will be discussed in more detail below.

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[3] For example, the contract between Winston and Diversified contained a provision which required the consummation of financing arrangements within sixty (60) days from the signing of the contract and provided for notice of this fact to Diversified. This was set out in Article 23 of that document, which further provided that:

> This contract is conditioned upon the consummation of the loan financing of construction cost by the owner with the Fulton National Bank of Atlanta and the consummation of the permanent financing by the owner with First Federal Savings and Loan Association of Rochester, New York, and upon the consummation of said financing the owner will notify the contractor by letter addressed to the contractor at 3390 Peachtree Road, N.E. Suite 1544 by registered mail and upon receipt of said letter this condition shall be satisfied and no longer effective but in the event the said letter is not received by the contractor within sixty (60) days from date, this contract shall become null and void.

In fact, permanent financing was not solidified until late December, 1967, beyond the 60-day provision of that Article, 8.3.

Continental, the surety herein, argues that this delay beyond the term specified in Article 23 resulted in the voiding of the entire contract. We note, however, that while this particular term of the contract was not followed, neither Winston, Diversified, nor Continental raised any objection at the time this alleged breach occurred, or sought then to invalidate the entire contract. A bond premium, in the sum of $6,444.00 was paid to Continental's agent on or about January 26, 1968, beyond the 60-day term, and all parties proceeded thereafter in accordance with the other terms of the contract. These acts of the surety constitute a legal waiver of the term provision of Article 23 of the contract and we therefore do not think that this contention of Continental's is well taken.

In the past many Georgia courts followed the rule that a compensated surety was not a favorite of the law and had to show that a novation was detrimental to it before being entitled to a discharge. See *Peachtree Roxboro Corp. v. United States Casualty Co.*, 101 Ga.App. 340, 114 S.E.2d 49, 53 (1960); also see *United States v. Algernon Blair, Inc.*, 329 F.Supp. 1360 (D. S.C. 1971) (under Georgia and South Carolina law). This rule is similar to the view taken by the Restatement, see *Restatement of* Security, Sec. 128(b) and by the courts of Ohio, see *Indemnity Co. v. Granite Co.*, 100 Ohio St. 373 (1919); *American Guarantee Co. v. Cliff Wood Coal & Supply Co.*, 115 Ohio St. 524 (1926); *Carter v. Bernard*, 269 N.E.2d 139 (C.P. Montgomery Cty. 1971).

The present majority rule in Georgia, however, is now to the contrary. The controlling case law in that state, now codified in the Georgia Code, provides that "any change in the terms of the contract is considered a novation and discharges the surety in the absence of the latter's consent. The surety is also discharged by any act of the creditor which injures him or increases his risk. Ga. Code Annot. 103-202, 103-203."[4]

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[4]Sections 103-202 and 103-203 of the Georgia Code Annotated, which are the basis of the holding in the *Brunswick* case, provide, in material parts, as follows:

> Section 103-202 – "[a]ny change in the nature or terms of a contract is called a novation; such novation, without the consent of the surety, discharges him.
>
> Section 103-203 – "[a]ny act of the creditor . . . which injures the surety or increases his risk, or exposes him to a greater liability, shall discharge him . . ."

Brunswick Nursing & Construction Center, Inc. v. Great American Insurance Company, 308 F.Supp. 297 (S.D. Ga. 1970). Under this view a surety need not show that he was injured by the novation, see *Alropa Corporation v. Snyder*, 182 Ga. 305, 185 S.E. 352, a novation for these purposes being defined as "a change in the nature and terms of the contract," see *American Surety Company of New York v. Garber*, 114 Ga. App. 532, 151 S.E.2d 887 (1966).

Under these principles, it is plain that the April 7th revision of the contract constituted a novation within the meaning of Georgia law. Diversified's role in the construction of King's Inn was effectively ended by this novation and Winston entered, for the first time, into direct contractual relationships with the project's subcontractors. The contract of April 7th, therefore, has little relationship to the contract between Winston and Diversified as originally bonded by Continental. It cannot be maintained, as plaintiff attempts to do, that these changes were not material alterations or that they were permitted by the "addendums, modifications and amendments" clause of the bond. On the contrary, the agreement of April 7th entirely changed the operative legal relationships of the three parties to the surety contract by the elimination of one of them. Since these alterations of the contract were made without the approval of the surety and are novations under Georgia law, Continental must be discharged from its obligations under the bond. See *Lowndes Alliance Warehouse Co. v. Greene*, 17 Ga. App. 542, 87 S.E. 826 (1916); *Palmes v. Southern Mechanical Company*, 117 Ga.App. 672, 161 S.E.2d 413 (1968).

In addition, it is unmistakable that Winston failed to comply with the default provisions as set forth in Article 22 of the contract. The surety bond between Continental and Diversified incorporated the provisions of Article 22 which, by its express terms, provided that the surety was entitled to seven days written notice prior to a declaration of default.

It is conceded that this notice was never given to the surety. Winston did, of course, consider Diversified to be in legal default of the contract and its actions of April 7th must be interpreted as a functional declaration of the contractor's actual status.

Winston may have had excellent reasons for not complying literally with the default provisions of its contract. Such a declaration of default may well have added additional costs to the already swollen construction budget and jeopardized Winston's permanent financing. In a time of rising interest rates and tighter money markets its failure to abide by the provisions of Article 22 may have made good economic sense. See Record at 211. We do not believe, however, that a party to a contract can pick and choose among its provisions, following those which inure to his benefit and ignoring those which might cause him detriment. On the contrary, a party either chooses to honor a contract or for tactical reasons decides to proceed without its protection.

It is not entirely clear how timely notice pursuant to Article 22 would have advantaged the surety. However, it is conceivable that had Winston, in April, 1969, placed Diversified in default in a manner consistent with Article 22, Continental might have negotiated a settlement of its liability or the surety could have taken

steps to decrease, or fix or mitigate its duties under the bond. It is, of course, possible that Continental would have denied any responsibility to Winston on the grounds that the project was not commenced in a timely manner, or that the term of the bond had expired or for any other reason.[5] The Court has no way of knowing what the surety's public legal response, as distinct from the private suggestions of its servants, would have been had Winston properly declared the contract in default. Since Winston declined to assume the immediate economic risks inherent in declaring default, pursuant to Article 22, it failed to properly shift Diversified's contractual obligations to the surety.

Nor do we agree with Winston's contentions that a declaration of default would have increased its risks unreasonably. Even if the surety had, following proper notice of default, formally denied liability under the bond, Winston had the right, by the plain terms of Article 22, to take control of the construction site and the contractor's equipment within seven days of that

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[5]We note as to the issue of term that Continental agreed to bond a construction project which was to be completed in three hundred days. In fact, the nursing home took in excess of six hundred days to complete, or more than double the specified term of the bond. Continental does not argue that the term provisions of the bond of a compensated surety are absolute. See *Restatement of Security*, Sec. 129(2). It is, however, possible that Winston may have waived its rights under the bond by failing to declare default within a reasonable time after it became obvious that Diversified would be unable to satisfy its obligations under the construction contract. In light of the facts of the present case, it is not necessary that the Court reach and resolve this question of law.

notice. The principle of mitigation may well have required, and would certainly not have prevented Winston from proceeding as it in fact did under the contract of April 7th. If the surety had refused to negotiate on the grounds that it had been discharged by earlier acts of either Winston or Diversified, the plaintiff's equitable and legal standing, in regard to subsequent litigation, would have remained unsullied.

Even if we were to assume, *arguendo*, that timely notice of default would not have been beneficial to the surety, Winston was bound by its contractual obligations to give it in any event. It cannot be exonerated for not having done so on the ground that strict compliance with its contractual obligations may have resulted in economic injury. Winston elected not to proceed on its contract and will not now be heard to say that that same contract now affords it a remedy.

Under Georgia law, a "contract of suretyship must be strictly construed in the interest of the surety." *Peara v. Atlanta Newspapers, Inc.*, 120 Ga.App. 163, 169 S.E.2d 670 (1969); also see *Glasser v. Decatur Lumber & Supply Company*, 95 Ga.App. 665, 99 S.E.2d 330 (1950); *Maryland Casualty Co. v. McAlpin*, 31 Ga.App. 330, 120 S.E. 644. The courts of that state have further noted that: "[T]he undertaking of a surety being stricti-juris, he cannot, in law or equity, be bound further than the very terms of his contract." *Mayor of Savannah v. Glen Falls Insurance Co.*, 104 Ga.App. 879, 123 S.E.2d 293 (1961); also see *Peara v. Atlantic Newspapers, Inc., supra*, 169 S.E.2d at 671; *Glen Falls Insurance Co. v. Wright Contracting Co.*, 276 F.Supp.

122, 131 (D. Md. 1965) (under Maryland law.)[6] For all of the foregoing reasons the Court does not believe that Winston's claims under the bond are meritorious.

Winston also asserts as a basis for recovery against the defendant, in addition to its claim on the bond, a common law theory in both contract and tort. It argues that Continental's acts, which included a failure to disclose information regarding Diversified's financial status and a refusal to reveal in advance of claim several potential defenses to the bond, constituted a violation of the duty of good faith owing from a surety to its obligee. Plaintiff places primary reliance for these contentions in the doctrine of *Trinity Universal Insurance Company v. Gould*, 258 F.2d 883 (C.A.10 1958) (under Kansas law).

We do not believe that *Trinity* can be reconciled with accepted principles of Georgia surety law. As we have noted above, contracts of surety in Georgia must be "... strictly construed in the interest of the surety." *Peara v. Atlanta Newspapers, supra*, and other cases

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[6]The plaintiff argues that under the holding of *Peachtree Roxboro Corp. v. United States Casualty Co., supra*, it was under no absolute requirement to give notice of Diversified's default to the surety. This is certainly true as far as it goes but we do not believe the *Peachtree* principle is controlling in the instant case. The bond under litigation in *Peachtree*, unlike the one at bar, did not require "... notice of any default to be given by the plaintiff." *Peachtree Roxboro v. United States Casualty Co., supra*, 114 S.E.2d at 53. The case law of Georgia clearly establishes that there is no absolute duty to give the surety notice of a major default by the contractor absent a contractual obligation to do so. We note, only in passing, that this view is not inconsistent with the view prevailing in this Circuit. See *United States v. Ohio Casualty Insurance Co.*, 399 F.2d 387 (C.A.6 1968).

cited at 11. A duty of good faith may well be imposed upon any party to a surety contract but it cannot extend to relieve the obligee of duties and responsibilities which properly repose in him. Strict compliance with the provisions of Article 22 by Winston was a condition precedent to Continental's liabilities, if any, under the bond. There is no way of ascertaining whether the surety would have met its duty of good faith under the bond, informal memos of its agents notwithstanding, as the condition precedent to that duty was never properly discharged.

Nor does this Court believe that any obligation devolved upon Continental to inform Winston of Diversified's economic straits. This information was ascertainable upon reasonable investigation and soon after construction began it was obvious to both the surety and the obligee that Diversified was incapable of proceeding in an acceptable manner under the contract. In the usual course, the converse of the position urged by plaintiff upon the Court is true. Since the obligee contracts initially with the principal, it often does so following an investigation. In the course of that investigation it may discover information regarding the principal which tends to affect the surety's risk and which is kept from the surety's attention. In these situations the general rule and the one in force in this Circuit is that the obligee is under no duty to disclose this information. See *United States v. Ohio Casualty Insurance Co., supra,* 399 F.2d at 389; *Magee v. Manhattan Life Insurance Co.,* 92 U.S. 93 (1876). We can perceive no reason why a different rule should be imposed where the surety possesses information accessible to, and indirectly known by, the obligee. Once

Winston knew that Diversified, for whatever reason, would be unable to meet the requirement of the contract, it had the option of placing the principal in default but it failed to exercise this right. Plaintiff's ultimate harm was not, therefore, a consequence of Continental's failure to disclose.

Several other issues have been advanced and briefed by the parties, but finding as we have above, it becomes unnecessary to reach these.

The foregoing shall constitute our findings of fact and conclusions of law as required by Rule 52, Fed. R. Civ. P.

Accordingly, on the basis of the evidence and for the reasons and authorities as set forth above, judgment shall be entered in favor of defendant Continental Casualty Company and against plaintiff Winston Corporation.

It is so ORDERED.

/s/ Carl B. Rubin
United States District Judge

IN THE
DISTRICT COURT OF THE UNITED STATES
FOR THE SOUTHERN DISTRICT OF OHIO
EASTERN DIVISION

FILED
John D Lyter, Clerk
June 20 422 PM '73

U.S. District Court
Southern Dist. Ohio
East. Div. Columbus

The Winston Corporation,
Plaintiff,

v. Civil No. 70-179

Continental Casualty Company,
Defendant.

ORDER

This matter comes before the Court on plaintiff Winston Corporation's motion, pursuant to Rule 59(e), Fed. R. Civ. P., for a reconsideration of our Opinion and Order of March 2, 1973, as finalized by Judgment March 13, 1973.

In our view the factual and legal issues presented in this case were fully discussed and resolved by our earlier Order and will not be repeated here. It must be kept in mind that in this diversity action, under applicable principles of conflict of laws, we sit as a Georgia court, applying the law of Georgia as it would be applied by a judge of that state. This we have tried

to do and the conclusions of our legal research are set forth in our Opinion of March 2, 1973.

Under these circumstances we would deem it inappropriate to attempt to graft the perhaps more enlightended or liberalized views of other jurisdictions, see, for example, *Trinity Universal Insurance Company v. Gould,* 258 F. 2d 883 (C.A. 10 1958) upon what we deem to represent settled principles of the jurisprudence of Georgia. As we noted in our earlier Opinion, a different result may well have obtained under Ohio surety law. See *Id.*, at 7 (slip opinion). Had the parties at the time they negotiated their contract included a "forum-selection" clause, wherein it was provided that the law of Ohio or some other state, would govern the resolution of any disputes under the contract, this Court would have, in all likelihood, honored such a provision. See *M/S Bremen vs. Zapata Off-Shore Co.*, 407 U.S. 1(1972). Since the parties failed to do this strict Georgia law of suretyship, which makes relatively little differentiation between compensated and uncompensated sureties, is a bar to plaintiff's recovery.

Nor do we think it appropriate to write what may be our own personal views of what is correct upon the surety law of Georgia. A functioning system of law, as contrasted with one of men, at times demands that the personal beliefs or caprices of individual judges be subordinated to established principles of law. If the surety law of Georgia is out of joint, surely it is for the legislature and the judges of that state, who have continuous contacts with the purported problems, and not for this Court, whose contact is fortuitous, to set it right.

Accordingly, plaintiff's motion for reconsideration is without merit and the same is hereby DENIED. The judgment of March 13, 1973 is, therefore, RE-INSTATED.

It is so ORDERED.

/s/ Carl B. Rubin
United States District Judge

APPENDIX C

No. 73-1886
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

FILED
APR 2 1975
JOHN P. HEHMAN, Clerk

THE WINSTON CORPORATION,
Plaintiff-Appellant

- vs -

CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee

ORDER

BEFORE: WEICK and MC CREE, Circuit Judges, and CONTIE,* District Judge.

A petition for rehearing with suggestion for a rehearing en banc having come on to be heard and the suggestion for a rehearing en banc not having been adopted, upon consideration, it is ORDERED that the petition be, and it hereby is, DENIED.

Entered by order of the court

/s/John P. Helman
Clerk

*The Honorable Leroy J. Contie, Judge, United States District Court for the Northern District of Ohio, sitting by designation.

APPENDIX D

FILED
JOHN D. LYTER, CLERK
APR 28 11 18 AM '75
U.S. DISTRICT COURT
SOUTHERN DIST. OHIO
EAST. DIV. COLUMBUS

FILED
JAN 17 1975
JOHN P. HEHMAN, Clerk

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

No. 73-1886

THE WINSTON CORPORATION,
Plaintiff-Appellant,

v.

CONTINENTAL CASUALTY COMPANY,
Defendant-Appellee.

Before: WEICK and McCree, Circuit Judges, and CONTIE, District Judge.

JUDGMENT

APPEAL from the United States District Court for the Southern District of Ohio.

THIS CAUSE came on to be heard on the record from the United States District Court for the Southern District of Ohio and was argued by counsel.

ON CONSIDERATION WHEREOF, It is now here ordered and adjudged by this Court that the judgment of the said District Court in this cause be and the same is hereby reversed and remanded for entry of judgment for appellant.

It is further ordered that Plaintiff-Appellant recover from Defendant-Appellee, the costs on appeal, as itemized below, and that execution therefor issue out of said District Court.

ENTERED BY ORDER OF THE COURT.

/s/John P. Hehman
Clerk

A True Copy.
Attest:

/s/John P. Hehman
John P. Hehman, Clerk

Issued as Mandate: April 15, 1975

COSTS: To be recovered by Appellant

Filing fee	$ 25.00
Printing	$491.20
Total	$516.20

APPENDIX E

CONTINENTAL CASUALTY COMPANY

General Office
310 South Michigan Avenue
Chicago 4, Illinois

PERFORMANCE AND PAYMENT BOND

KNOW ALL MEN BY THESE PRESENTS:

That we Diversified Engineering & Sales Corporation, Atlanta, Georgia, and David W. Knight, Atlanta, Georgia, as PRINCIPAL, and CONTINENTAL CASUALTY COMPANY, an Illinois Corporation, 310 South Michigan Avenue, Chicago, Illinois, as SURETY, are held and firmly bound unto The Winston Corporation, Atlanta, Georgia as OBLIGEE, in the penal sum of Seven hundred fifty-two thousand, eight hundred seventy-four and no/100 ($752,874.00) Dollars, for the payment of which, well and truly to be made, we bind ourselves, our heirs, administrators, successors and assigns, jointly and severally, firmly by these presents.

WHEREAS, the above bounden Principal has entered into a certain written contract with the above named Obligee, dated the 3rd day of October, 1967, for

All labor and materials for the construction of the King's Inn Nursing Home in conformity with the plans, specifications, addendums, modifications, and and [sic] amendments.

which contract is hereby referred to and made a part hereof as fully and to the same extent as if copied herein.

NOW, THEREFORE, THE CONDITION OF THE ABOVE OBLIGATION IS SUCH, that if the above bounden Principal shall well and faithfully perform the things agreed by him to be performed, according to the terms, conditions, and requirements of the foregoing contract; and shall pay all persons who have furnished labor or material for use in or about the improvement; and shall indemnify and save harmless the Obligee, and its officers, agents and employees, from any and all claims for damages, costs, judgments, and other expenses, arising or growing out of this contract; then, this obligation shall be null and void, otherwise, the same shall remain in full force and effect.

IN WITNESS WHEREOF, we have hereunto set our hands and seals the 3rd day of October, 1967.

WITNESSES:
Owen M. Burdette
Owen M. Burdette
C.C. Durden

Diversified-Engineering & Sales Corporation
By:
/s/ Vance C. Dyar
Vance C. Dyar, President
By: /s/ David W. Knight
David W. Knight

CONTINENTAL CASUALTY COMPANY
By: Owen M. Burdette
Attorney in Fact